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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 487

WILLIAM MALAT AND ETHEL MALAT, PETITIONERS

v.

ROBERT A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-9) is reported at 347 F. 2d 23. The memorandum opinion and conclusions of law of the district court (R. 9-29)[1] are not officially reported.

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[1] "R." refers to Vol. I of the original transcript of the record in the district court. "Tr." refers to the transcript of the proceedings contained in Vols. II and III of the record in the district court. All three volumes have been filed with the Clerk of this Court.

JURISDICTION

The judgment of the court of appeals was entered on May 27, 1965 (R. 51). The petition for a writ of certiorari was filed on August 23, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the lower courts correctly ruled that certain property was held primarily for sale to customers in the ordinary course of business and, accordingly, that the taxpayer's[2] profit from the sale of the property is taxable as ordinary income rather than as capital gain.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 61. GROSS INCOME DEFINED.
>
> (a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, and similar items;
>
> (2) Gross income derived from business;

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[2] For convenience William Malat is referred to as "taxpayer", although his wife, Ethel Malat, is also a petitioner by reason of having filed a joint return with her husband for the 1956 tax year.

(3) Gains derived from dealings in property;

* * * *

(26 U.S.C. 61.)

SEC. 702. INCOME AND CREDITS OF PARTNER.

* * * *

(b) *Character of Items Constituting Distributive Share.*—The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (8) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

* * * *

(26 U.S.C. 702.)

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

* * * *

(26 U.S.C. 1221.)

SEC. 1222. OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES.

For purposes of this subtitle—

* * * *

(3) *Long-Term Capital Gain.* — The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income.

* * * *

(26 U.S.C. 1222.)

STATEMENT

The facts are set forth in detail in the findings of the district court (R. 23-28), and may be summarized as follows:

During the taxable year 1956 the taxpayer was a general partner of Louis Lesser Enterprises, Ltd. ("Lesser"), a partnership. Lesser, in turn, was a partner with four individuals in Century Crenshaw Plaza ("Plaza"), in which each partner had a 20 per cent interest in capital, profits and losses. In 1954 Plaza acquired for $486,000 a parcel of real estate in Inglewood, California (R. 24-25).

The land originally had been zoned for agricultural purposes, but prior to the acquisition it had been rezoned for multiple residential dwellings. When Plaza acquired the property, the partners intended either to sell it or to develop it for rental, depending on which course appeared to be most profitable. They realized that they had made a good pur-

chase price-wise, and that if they were unable to obtain acceptable construction financing or rezoning for commercial purposes, they could sell the property in bulk so that they "wouldn't get hurt." Plaza continued to have this purpose of either selling or developing the property as long as it held the land (R. 25-26).

The development of the property as a multiple residential project was contingent on obtaining financial guarantees by the Federal Housing Administration, which could not be secured on terms acceptable to Plaza. Plaza was unable to develop commercially the frontage property along two sides of the tract and to develop the remainder into a multiple residential project, since it could not obtain the necessary conventional financing necessary for the apartment project and could not secure a zoning change for the frontage property (R. 26).

After Plaza had failed to obtain rezoning or acceptable financing, a rift arose among the partners, which made further business relations unpleasant (R. 26-27). Plaza then subdivided part of the land into individual lots, which it sold. Both Plaza and its partners reported the gains from such sale as ordinary income.

After it sold the individual lots, Plaza sold the frontage property, and reported its profits therefrom as long-term capital gains. Lesser (one of the partners of Plaza) in turn treated on its partnership information return its distributive share of such profits as capital gains, and the taxpayer similarly

treated his distributive share of the gains reported by Lesser (R. 27-28, Exs. A and B, Tr. 138).

The Commissioner ruled that the profits on the sale of the two frontage tracts were ordinary income rather than capital gain. The district court upheld this ruling. It found that Plaza held the property either for development or for sale, depending on which appeared to be most profitable, and that the taxpayer had failed to establish that the property was not held by Plaza primarily for sale to customers in the ordinary course of its trade or business (R. 28-29). The court of appeals affirmed, holding that the record supports the district court's finding that the property was held primarily for sale (Pet. App. 1-9).

ARGUMENT

Section 1221(1) of the Internal Revenue Code of 1954 (*supra*, p. 3) specifically excludes from the category of capital assets, the profits on the sales of which are treated as capital gain rather than as ordinary income, "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Whether particular property is so held is largely a factual question, in the determination of which no single factor is controlling. Thus, the decision of this issue lies primarily within the discretion of the trial court, and its conclusion is not to be disturbed unless clearly erroneous.[3] In the present case, the district court found

[3] See, e.g., *Yara Engineering Corp.* v. *Commissioner*, 344 F. 2d 113 (C.A. 3); *Margolis* v. *Commissioner*, 337 F. 2d 1001 (C.A. 9); *Ackerman* v. *United States*, 335 F. 2d 521

that Plaza held the two frontage parcels primarily for resale, and the court of appeals upheld that finding as having adequate evidentiary support. This Court repeatedly has declined to review the factual determination that particular property was held primarily for sale,[4] and there is similarly no occasion for further review of that narrow issue here.

In any event, the evidence supports the trial court's finding that Plaza held the property primarily for sale to customers. Although the participants in

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(C.A. 5); *Coffey* v. *United States*, 333 F. 2d 945 (C.A. 10); *Broughton* v. *Commissioner*, 333 F. 2d 492 (C.A. 6); *Wineberg* v. *Commissioner*, 326 F. 2d 157 (C.A. 9); *Recordak Corp.* v. *United States*, 325 F. 2d 460 (Ct. Cl.); *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198 (C.A. 6), certiorari denied, 375 U.S. 992; *Los Angeles Extension Co.* v. *United States*, 315 F. 2d 1 (C.A. 9); *Bauschard* v. *Commissioner*, 279 F. 2d 115 (C.A. 6); *Harry Slatkin Builders* v. *Commissioner*, 235 F. 2d 189 (C.A. 6), certiorari denied, 352 U.S. 928; *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263 (C.A. 9); *Harriss* v. *Commissioner*, 143 F. 2d 279 (C.A. 2). Indeed, the taxpayer here strongly asserted in the district court that the issue was factual (Amended Pre-trial Conference Order, par. VIII, R. 7).

[4] See, e.g., *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198 (C.A. 6), certiorari denied, 375 U.S. 992; *American Can Co.* v. *Commissioner*, 317 F. 2d 604 (C.A. 2), certiorari denied, 375 U.S. 993; *S.E.C. Corp.* v. *United States*, 241 F. 2d 416 (C.A. 2), affirming *per curiam*, 140 F. Supp. 717 (S.D. N.Y.), certiorari denied, 354 U.S. 909; *Harry Slatkin Builders* v. *Commissioner*, 235 F. 2d 189 (C.A. 6), certiorari denied, 352 U.S. 928; *Shearer* v. *Smyth*, 221 F. 2d 478 (C.A. 9), certiorari denied, 350 U.S. 840; *Rubino* v. *Commissioner*, 186 F. 2d 304 (C.A. 9), certiorari denied, 342 U.S. 814; *King* v. *Commissioner*, 189 F. 2d 122 (C.A. 5), certiorari denied, 342 U.S. 829.

Plaza originally hoped to develop the entire property as a garden-type apartment, they recognized that such development was contingent upon obtaining the necessary rezoning and adequate financing, and they always intended that, if such rental development turned out either to be impossible or to be less profitable than sale, they would sell the property. As the court of appeals noted (Pet. App. 4-5), the taxpayer himself testified, in response to the question whether he "contemplate[d] * * * the possibility that rezoning or refinancing, or whatever, might not be possible?" that

> * * * we felt that we had made a good buy on the property as far as price is concerned, so that if we couldn't do anything in the way of zoning, we would sell the whole thing off in bulk. We wouldn't get hurt.

On the basis of this testimony, the district court concluded (Pet. App. 5) that the property "was purchased with the thought in mind that if the rezoning or appropriate financing could not be accomplished that the parties 'would sell the whole thing off in bulk. We wouldn't get hurt.' "

Thus, as the court of appeals ruled (Pet. App. 7-9), "the property was acquired and held with the purpose of realizing gain from it in any feasible manner which might present itself"; "the many possibilities of gain possessed by the property (including subdivision and sale) * * * were in turn explored by the owners"; and when the property finally was sold, it was "not the liquidation of an investment" but "the final alternative in taxpayer's

continuing efforts to realize gain from his acquisition." Where property is so held for the express purpose either of selling it or of retaining it for development—and the possibility of sale is not merely the implicit recognition that if the investment should prove unattractive, it would be liquidated—it is "held * * * primarily for sale to customers" within the meaning of Section 1221(1) of the Code. *Recordak Corp.* v. *United States*, 325 F. 2d 460 (Ct. Cl.); *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198 (C.A. 6), certiorari denied, 375 U.S. 992; *Greene-Haldeman* v. *Commissioner*, 282 F. 2d 884 (C.A. 9); *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263 (C.A. 9).

2. Contrary to petitioners' contention (Pet. 7-9), the decision below does not conflict with either *Gotfredson* v. *United States*, 303 F. 2d 464 (C.A. 6), or *Municipal Bond Corporation* v. *Commissioner*, 341 F. 2d 683 (C.A. 8). In *Gotfredson* an instruction that the jury should hold for the government if it found that cattle were held for the dual purpose of breeding and sale was held erroneous not on the ground that the dual purpose theory was wrong, but that there was no evidence there of such purpose. In the present case, however, both courts below found as a fact that there was a dual purpose. Indeed, subsequent to *Gotfredson* the Sixth Circuit apparently approved the dual purpose theory. See *Meridian, Inc.* v. *Commissioner*, 322 F. 2d 198, 200 (C.A. 6), certiorari denied, 375 U.S. 992.

In *Municipal Bond*, the Eighth Circuit reversed the Tax Court's finding that the taxpayer held real

estate primarily for sale. It held that the Tax Court had misconstrued "primarily" to mean "substantially"—a construction which the Tax Court stated "permits recognition of the dual purpose concept inherent in some types of business operations" (see 341 F. 2d at 687); and that the Tax Court had erred because it "did not base its findings and decision on a determination of the primary or predominant purpose of taxpayer in acquiring and holding the various properties" (p. 690). It is by no means clear, however, that the Eighth Circuit would reject the trial court's finding in the present case that the taxpayer held the property "primarily" for sale, where two purposes were equally important at the outset and, as the trial court in effect found, the sale purpose subsequently became "primary or predominant." Since the application of the statutory phrase turns so largely upon an evaluation of all the pertinent facts, there is no occasion to resolve any possible conflict with the Eighth Circuit unless and until the latter makes it unmistakably clear that no factual situation whatever could justify the dual purpose theory.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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